Industry Canada Industrie Canada

Q2 2008

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VENTURE CAPITAL MONITOR

A QUARTERLY REPORT ON THE CANADIAN VENTURE CAPITAL INDUSTRY

Canadian high growth innovative small and medium-sized enterprises (SMEs) that commercialize research depend to a large extent on the venture capital (VC) industry for funding. Therefore, a strong VC industry is important for the growth of this segment of SMEs. The goal of this series is to provide current information about the VC industry in Canada. To this end, the series will track trends in investment activity, report on topical VC-related research and look at key technology clusters where VC investment is taking place.

INTRODUCTION

This issue discusses Canada's venture capital (VC) activity during Q2 2008. This issue was delayed because of the federal election. Due to its late publication date, this issue does not contain the usual articles on Canadian technology clusters and business incubation. These stories will resume in the next issue with articles on the Toronto technology cluster and the business incubator InNOVAcorp in Halifax.

VC ACTIVITY OVERVIEW

Investment and fundraising

Investments decline/fundraising rebounds relative to Q2 2007

Venture capital activity in Canada continued its slowdown, with $302M invested in Q2 2008, a decline of 31 percent from $436M invested in Q2 2007 and 10 percent from $334M invested in Q1 2008 (Table1). The overall decline for the first half of 2008 compared with the first half of 2007 is 39 percent, down from $1045M to $635M.

Fundraising, on the other hand, rebounded in Q2 2008 with $356M raised, up 31 percent from $272M raised in Q2 2007. Despite this rebound, the $690M raised during the first half of 2008 is still 7 percent lower than the $739M raised during the first half of 2007.

Table 1
VC investment and fundraising in Canada, Q2 2007 and Q2 2008

	Q2 2007	Q2 2008	% Change
	($ millions)		
Investment	436	302	-31
Fundraising	272	356	31

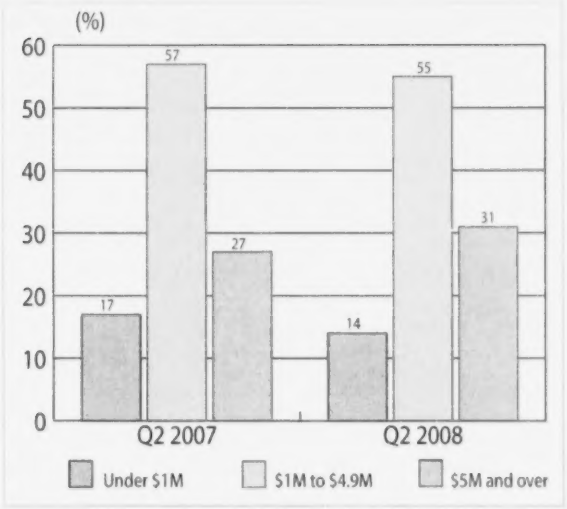
Source: Thomson Financial 2008.

Deal size

Deal size unchanged

Deal size for Q2 2008 was $2.8M, on average, down 7 percent from $3M registered in Q2 2007. Foreign investors' average deal size is still notably higher than that of domestic investors, with foreign funds investing $4.25M per deal, on average, compared with $2.4M for domestic funds. Overall, there was no noticeable change in deal size pattern in Q2 2008 compared with Q2 2007 (Figure 1). Deals of $1M to $4.99M continue to dominate, with deals of less than $1M declining slightly. It should be noted that the drop in deal size has been accompanied by a drop in the number of companies receiving VC funding from 145 in Q2 2007 to 105 in Q2 2008.

Figure 1
VC deal size



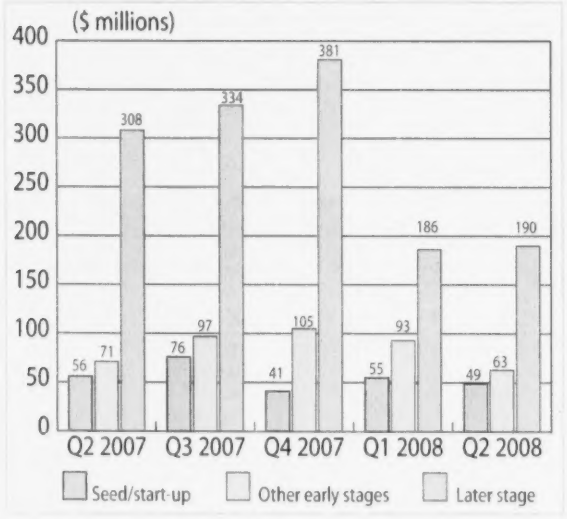
Source: Thomson Financial 2008.

Stage of development

Decline in VC investment affects all stages of development

The decline in VC investment observed in 2008 has affected all stages of development in approximately equal proportions (Figure 2). Investments in later stages of development represented 63 percent of total VC investment in Q2 2008, somewhat lower than the 71 percent share in Q2 2007.

Figure 2
VC investment by stage of development, Q2 2007 to Q2 2008



Source: Thomson Financial 2008.

New versus follow-on investments

New seed and start-up deals decline in Q2 2008

New deals in the seed/start-up stage declined sharply in Q2 2008, with only eight new deals compared with 20 in Q1 2008 and 12 in Q2 2007 (Table 2). In contrast, follow-on deals were mainly concentrated on later stage companies. Overall, there were 20 new deals in Q2 2008 compared with 46 in Q2 2007, which implies that 20 companies received first-time VC funding in Canada in Q2 2008.

Type of investor

Continued decline in LSVCC/retail investments

Although investments by all types of investors dropped in Q2 2008 compared with Q2 2007, labour sponsored venture capital corporation (LSVCC)/retail investments had a markedly higher decline (40 percent) that affected Quebec more than any other province (Table 3). It is worth noting that the Fonds de solidarité de la Fédération des travailleurs du Québec (FTQ), a Quebec-based LSVCC, has been active as a limited partner (GO Capital, MSBI II) and has made fewer direct investment in portfolio companies, which contributed to the drop in LSVCC investments. Despite the drop in foreign fund investments, their share increased from 28 percent in Q2 2007 to 35 percent in Q2 2008.

Table 2
New versus follow-on VC deals, Q2 2007 to Q2 2008

		Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008
New	All	46	53	43	43	20
	Seed/start-up	12	23	14	20	8
	Other early stages	8	6	5	5	1
	Later stage	26	24	24	18	11
Follow-on	All	99	87	86	85	87
	Seed/start-up	14	8	10	15	15
	Other early stages	26	27	22	27	20
	Later stage	59	52	54	43	52

Source: Thomson Financial 2008.

Table 3
VC investment by type of investor, Q2 2007 and Q2 2008

	Q2 2007	Q2 2008	% Change
	($ millions)		
LSVCC/ retail funds	121	72	-40
Private independent funds	67	56	-16
Foreign funds	124	106	-15
Others*	124	68	-45

* Includes corporate funds, institutional investors, government funds and others.

Source: Thomson Financial 2008.

Fundraising

Fundraising rebounds in Q2 2008

Fundraising in Q2 2008 registered a sudden rebound, increasing 31 percent compared with Q2 2007 (Table 4). Fundraising was mostly driven by private independent funds that raised $259M in capital commitments — 73 percent of the total and a 36-percent increase over Q2 2007. LSVCC/retail funds raised $97M, an increase of 20 percent over Q2 2007.

Table 4
VC fundraising, Q2 2007 and Q2 2008

	Q2 2007	Q2 2008	% Change
	($ millions)		
LSVCC/ retail funds	81	97	20
Private independent funds	191	259	36
Total	272	356	31

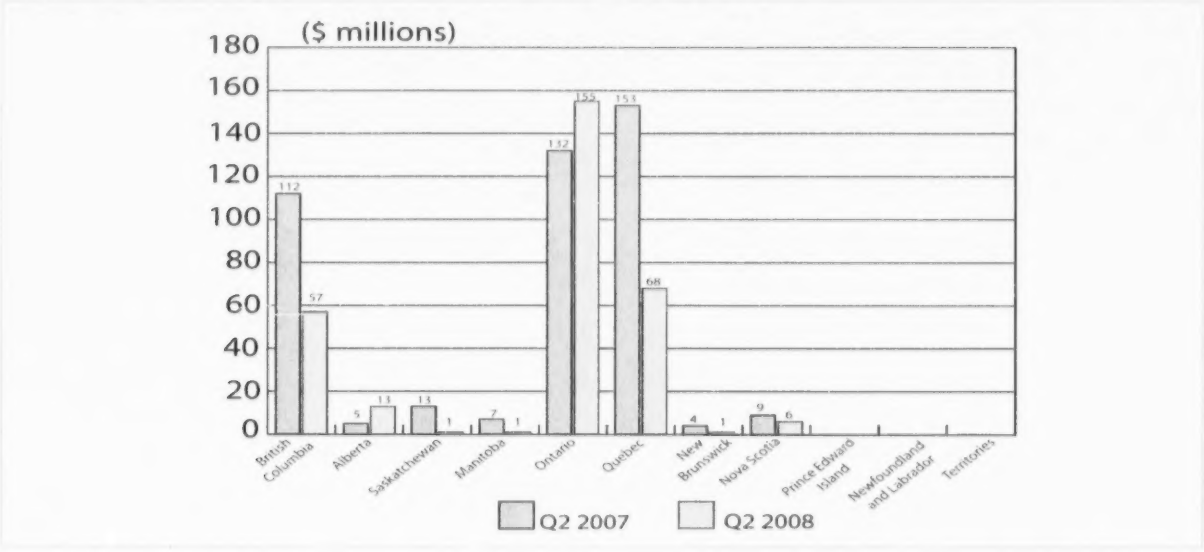
Source: Thomson Financial 2008.

Regional distribution

Quebec experiences a sharp drop in VC investments

VC investment in Ontario increased 17 percent in Q2 2008 compared with Q2 2007 (Figure 3). All other provinces, except Alberta, experienced a drop in VC investment in Q2 2008, with VC investment in Quebec decreasing by 56 percent compared with Q2 2007. A drop in foreign investment and LSVCC funds was responsible for 50 percent of this decline. The drop in investment has also been reflected in the number of deals per province (Table 5).

Figure 3
Regional distribution of VC investment in Canada, Q2 2007 and Q2 2008



Source: Thomson Financial 2008.

Table 5
Regional distribution of deals, Q2 2007 and Q2 2008

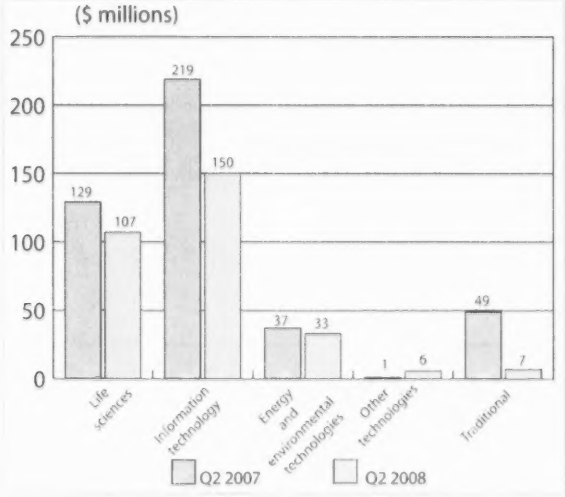
	Q2 2007	Q2 2008	% Change
British Columbia	20	17	-15
Alberta	2	5	150
Saskatchewan	3	1	-67
Manitoba	4	1	-75
Ontario	37	43	16
Quebec	72	33	-54
New Brunswick	2	2	0
Nova Scotia	5	5	0
Prince Edward Island	–	–	–
Newfoundland and Labrador	–	–	–
Territories	–	–	–

Source: Thomson Financial 2008.

Industry sector distribution

VC investment decreased across all sectors in Q2 2008, with the traditional sector hardest hit by an 86-percent drop from $49M in Q2 2007 to $7M in Q2 2008 (Figure 4). VC investment in the information technology (IT) sector dropped 31 percent, a somewhat larger drop than in life sciences.

Figure 4
VC investment in Canada by sector of activity, Q2 2007 and Q2 2008



Source: Thomson Financial 2008.

GOVERNMENT ACTIVITIES

In Q2 2008, the Business Development Bank of Canada (BDC) committed $15.2M in venture capital, together with $89.3M committed by co-investors, in 13 deals (Table 6).

Table 6
BDC deals in Q2 2008

	BDC	Co-investors	Total	Number of deals
	($ millions)			
Start-up	3.5	26.7	30.2	2
Other early stages	7.9	26.1	34.0	5
Later stage	3.8	36.6	40.4	6
Total	15.2	89.3	104.6	13

Source: Business Development Bank of Canada 2008.

The Ontario Ministry of Research and Innovation announced in June that the new $205M Ontario Venture Capital fund is open for business. The fund is a limited partnership established between the Government of Ontario and leading institutional investors to invest primarily in Ontario-focused venture capital and growth funds. TD Capital Private Equity Investors has been selected to manage the fund.

The Government of Quebec announced two new Regional Economic Intervention Funds (FIER) in April. These risk-capital funds are the $3M Fonds-Soutien Côte-Nord and $5M FIER-Gaspésie.

The Government of Alberta's action plan Bringing Technology to Market, announced in June, aims to increase the number of new companies in emerging advanced technology sectors. This $178M plan highlights a range of actions, including increased investment capital to technology.

NOTES

This publication is part of a series prepared by the Small Business and Tourism Branch. The branch analyses the financial marketplace and how trends in this market impact small businesses' access to financing. Current research is focused on high-growth firms, the aspects of both Canada's VC and general business environment that affect the success of these firms, and the key players in the risk-capital market (for example, VC firms and angels).

The Small Business and Tourism Branch is also responsible for the Small and Medium-Sized Enterprise Financing Data Initiative (SME FDI). The SME FDI is a comprehensive data-collection program on SME financing in Canada. In partnership with Statistics Canada and Finance Canada, Industry Canada reports on the supply of and demand for financing by small and medium-sized businesses. Further information and statistical findings and reports are available at www.sme-fdi.gc.ca.

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